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## **Fiduciary duties as implied contractual terms**

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In *MacRoberts LLP v McCrindle Group Ltd*<sup>1</sup> the Inner House of the Court of Session examined the nature of a solicitor's duty to avoid placing himself in a position of actual or potential conflict of interest. The central question was whether this duty was an implied term in the solicitor's contract to provide professional services, or a fiduciary duty imposed by law on a contractual fiduciary relation. The qualification of the no-conflict duty as an implied contractual term was essential for the defenders' case. Their argument was that, by placing themselves in a potential conflict of interest, the solicitors committed a material breach of contract which, under the principle of mutuality, exonerated the defenders from their contractual obligation to pay fees. The court ruled unanimously that, although the fiduciary relation was created by contract, the resulting fiduciary duties are not contractual. Fiduciary duties and contractual obligations are distinct concepts with distinct consequences. Consequently, the breach of the no-conflict duty by the solicitor was not regarded as a breach of an implied term in the contract for provision of legal services.

### **A. THE FACTS**

The pursuers, MacRoberts LLP (ML) acted as solicitors for the defenders, McCrindle Group Ltd (MGL), in relation to a dispute with MGL's former solicitors, Maclay Murray & Spens (MMS). MMS represented MGL in a contractual dispute with Haden Young Ltd, which was referred to arbitration in 1992 and which was settled in 2004. MMS failed to advise MGL that the arbiter had no power to award interest for the period prior to the date of his decree arbitral, and failed to raise protective court proceedings to preserve MGL's entitlement to the pre-award interest. In 2002, MGL hired ML to represent them in their claim against MMS for breach of contract and professional negligence, as well as to take over the representation of MGL in the Haden Young arbitration. The action against MMS was raised in 2005, but sisted until 2011.

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<sup>1</sup> *MacRoberts LLP v McCrindle Group Ltd* [2016] CSIH 27.

Meanwhile, ML and MGL continued to negotiate with Haden Young. MGL's instructions were given by William McCrindle, the managing director, and the ML partner responsible for carrying out those instructions was Richard Barrie. In May 2003, a series of discussions and negotiations took place with a view to achieving a settlement, but Haden Young's offers were unacceptable to MGL. On 29 May 2003, the parties met for a further attempt to settle the arbitration. Mr McCrindle made it clear to Mr Barrie that he was not willing to settle without clarifying the issue of pre-award interest. He was concerned that a failure to address this point may have a negative impact on the MMS litigation. More specifically, he was concerned that MMS's professional insurance company could argue that there had been an entitlement to interest which ought to have been taken into account in the settlement with Haden Young, and which could not therefore be recovered from MMS. The arbitration dispute continued and was ultimately settled in 2004.

In 2011, the issue in the MMS litigation was recalled. MMS admitted negligence and breach of contract, but denied MGL's claim that their negligence caused MGL to obtain a less favourable settlement than that which it eventually achieved. Evidence of the negotiations on 29 May 2003 was critical for proving the sum that Mr McCrindle would have been prepared to accept. That evidence no longer existed, however, since ML had destroyed Mr Barrie's notes without retaining scanned copies. Furthermore, written evidence existed that suggested that Mr Barrie might have been discussing settling the arbitration at an amount unacceptable to Mr McCrindle. The apparent lack of support by Mr Barrie for Mr McCrindle's position, as well as the destruction by ML of the records of the 29 May meeting had the potential to affect negatively the credibility of Mr McCrindle's evidence in the MMS litigation. ML advised McCrindle that there was a potential conflict of interest between ML's interests and those of MGL, which could crystallise into an actual conflict of interest, and advised him to seek independent legal advice.

Mr McCrindle turned to another law firm, TLT LLP, who confirmed that there was a conflict of interest between ML and MGL in respect of the absence of the 29 May notes and Mr Barrie's acting beyond the scope of his authority. TLT took over the action against MMS and was successful on all claims.<sup>2</sup>

In 2012, ML sued MGL for unpaid fees amounting to £104,065. MGL did not contest this amount, but contended that it was not due because ML were in material breach of their contract to provide professional services by placing themselves in a position of conflict of

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<sup>2</sup> *McCrindle Group Ltd v Maclay Murray & Spens* [2013] CSOH 72.

interest. Alternatively, MGL contended that they were entitled to set off the fees with the damages they incurred as a result of ML's conflict of interest, consisting of expenses with the new firm of solicitors and fees paid to ML for work that would not have been required if the breach of contract had not occurred.

## **B. THE COURT DECISIONS**

The action came before Lord Tyre, Lord Ordinary in the Outer House of the Court of Session. The Lord Ordinary found that ML were not in material breach of their contractual duties.<sup>3</sup> Without discussing the fiduciary or contractual nature of the no-conflict duty, the Lord Ordinary held that ML did not breach such duty either in connection with the destruction of Mr Barrie's notebooks or as regards Mr Barrie's authority to act for Mr McCrindle.<sup>4</sup> Consequently, ML were entitled to payment of their fees.<sup>5</sup>

MGL appealed. It argued that the Lord Ordinary erred in law in failing to hold that, by destroying the written evidence of the 29 May discussions, ML placed themselves in a position where there was a real and sensible possibility of conflict of interest, and thus materially breached their contract.<sup>6</sup> The careless destruction of the notes created an interest in ML to deny that there ever was a note of the meeting in question, which came into conflict with their core duty to represent their client forcefully.<sup>7</sup> Consequently, under the principle of mutuality, which holds that a non-performing party is disabled from insisting on the performance by the other party of the correlative obligation, ML were disabled from seeking to enforce the obligation to pay their fees.<sup>8</sup> ML responded that the no-conflict duty invoked by MGL, although referred to by the defenders as a contractual term, "has all the aspects of a fiduciary duty".<sup>9</sup> Drawing on *Bristol and West Building Society v Mothew*,<sup>10</sup> the pursuers pointed out that, although the solicitor-client relation is fiduciary, not all breaches by a fiduciary are breaches of fiduciary duties. The failure to make scanned copies of the notes was a careless mistake that had no component of disloyalty or lack of fidelity, which are required for breach of fiduciary duty.<sup>11</sup>

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<sup>3</sup> *MacRoberts LLP v McCrindle Group Ltd* [2014] CSOH 99; 2015 SCLR 67.

<sup>4</sup> *Ibid.* at 84.

<sup>5</sup> *Ibid.*

<sup>6</sup> *MacRoberts LLP v McCrindle Group Ltd* [2016] CSIH 27 at [35].

<sup>7</sup> *Ibid.* at [37].

<sup>8</sup> *Ibid.* at [35]-[36].

<sup>9</sup> *Ibid.* at [40].

<sup>10</sup> *Bristol & West Building Society v Mothew* [1998] Ch 1.

<sup>11</sup> *MacRoberts LLP v McCrindle Group Ltd* [2016] CSIH 27 at [40].

Lord Brodie, writing the unanimous decision, sided with the pursuers. He noted that there was no disagreement with regard to the existence of a potential conflict of interest. ML raised this issue with MGL, and instructed them to seek independent advice.<sup>12</sup> MGL's case depended on whether ML was under an obligation not to allow a conflict to arise, which could be implied in its contract with ML. Lord Brodie observed that MGL's statements about the nature of the no-conflict duty were to some degree inconsistent and "slipped between contractual obligation and fiduciary duty."<sup>13</sup> The judge went to great lengths to highlight the differences between the two types of duties and the dangers of conflating them:

[The fact that] a solicitor has a particular duty arising from the fiduciary nature of his relationship with his client does not require the contract for the retainer to be analysed as containing an implied term not to breach the fiduciary duty. Such an analysis has no purpose. If a solicitor is under a duty by virtue of the fiduciary relationship, there is no need to re-impose it by the mechanism of contractual implication.<sup>14</sup>

The no-conflict fiduciary duty which arises from a fiduciary relation, Lord Brodie further observed, is different in content from the implied contractual duty alleged by the defenders. The fiduciary duty prevents a fiduciary from *placing* himself in a conflict situation, as opposed to the alleged implied contractual duty of *not finding* oneself in a position of conflict of interest.<sup>15</sup> The difference between the two is significant. The fiduciary duty is breached by deliberate action that carries with it an element of disloyalty or malice, whereas the alleged contractual duty would be breached by and inadvertent omission or carelessness.<sup>16</sup> If the view of the defenders were accepted, it would turn any negligent action that had potential to have adverse consequences on the client's interests into a breach of the implied no-conflict duty, because the solicitor would be tempted to conceal or minimise the consequences of the relevant action. Such an interpretation is overly broad and inconsistent with the way in which the contract for the provision of a solicitor's services is usually analysed.<sup>17</sup>

### C. COMMENTS

Are fiduciary duties contractual (voluntarily undertaken) or are they imposed by law and courts? This is an inveterate controversy in fiduciary law theory and there are strong

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<sup>12</sup> *Ibid.* at [43].

<sup>13</sup> *Ibid.* at [45].

<sup>14</sup> *Ibid.* at [50].

<sup>15</sup> *Ibid.* at [51], emphasis added.

<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid.* at [52].

arguments for both parts of the question. The answer to this question may have far-reaching implications in cases where the nature of the relation between two parties, or the scope of one party's fiduciary duties, is called into question. In such cases, the courts may find that fiduciary duties have arisen from specific circumstances, even if not expressly contemplated by the parties, or that the fiduciary duties override express provisions of their bargain. In other words, if fiduciary duties are consensual, they are restricted to the perimeter of the parties' express or implied wishes; if they are imposed, fiduciary law may override express or implied contractual terms in furtherance of other, higher-ranking, interests.<sup>18</sup>

On the one side of the debate there is the contractarian view, which dominates the current law and economics view of fiduciary duties. Its key tenet is that, because fiduciary relations are created by contract, fiduciary duties must accommodate to the terms of the contract, rather than override it.<sup>19</sup> In the contractarian view, the purpose of the fiduciary duties is to fill in the broad gaps in the fiduciary agreement. Fiduciary obligations perform a gap-filling function, akin to contractual implied terms.<sup>20</sup> Courts fill in the contractual gaps by supplying the terms the parties themselves would have agreed to, had they negotiated about the unanticipated circumstance at the outset.<sup>21</sup> In other words, the fiduciary duty of loyalty is a generic rule against conflicts of interest or unauthorised profits, which morphs into contractual provisions when applied *ex post* by courts in specific scenarios. From this perspective, fiduciary duties are standard terms in contracts derived and enforced in the same way as other contractual undertakings.<sup>22</sup>

On the other side, there are the anti-contractarians. The key insight of this set of theories is that the values underlying contracts and fiduciary relations are fundamentally different. In contracts parties are usually on equal footing and expected to further their own interest, within the limits of good faith, unconscionability and undue influence. Fiduciary relations, in contrast, have trust and confidence, vulnerability and dependency of one party to

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<sup>18</sup> See Anthony Duggan, "Contracts, Fiduciaries and the Primacy of the Deal" in Elise Bant and Matthew Harding, eds, *Exploring Private Law* (Cambridge: Cambridge University Press, 2010) 275.

<sup>19</sup> The prevailing contractarian model is founded on the principal-agent problem and the ensuing agency costs. The works of Cooter and Freedman, Easterbrook and Fischel, Langbein, and Sitkoff have played a decisive role in shaping the law and economics understanding of the fiduciary conflict of interest and of its economic and legal consequences. See Robert Cooter and Bradely Freeman, "The Fiduciary Relationship: Its Economic Character and Legal Consequences" (1991) 66 *New York University Law Review* 1045; Frank H. Easterbrook and Daniel R. Fischel "Contract and Fiduciary Duty" (1993) 36 *Journal of Law and Economics* 425; John H. Langbein, "The Contractarian Basis of the Law of Trusts" (1995) 105 *Yale Law Journal* 625; Robert Sitkoff, "An Economic Theory of Fiduciary Law" in Andrew Gold and Paul Miller, eds., *Philosophical Foundations of Fiduciary Law* (Oxford: OUP, 2014) Ch. 9.

<sup>20</sup> Duggan, *supra* note 18 at 278.

<sup>21</sup> Kelli Alces, "The Fiduciary Gap" (2015) 40 *Journal of Corporation Law* 351 at 365.

<sup>22</sup> Easterbrook and Fischel, *supra* note 19 at 427.

another, at their core.<sup>23</sup> Therefore, fiduciary duties and contractual obligations arise differently and differ in nature and purpose.

Although they diverge as regards the essential role and purpose of fiduciary duties, the contractarian and anti-contractarian views have important points in common. Both agree that fiduciary duties involve a voluntary undertaking from at least one party to the relation. Both agree that fiduciary duties require one party to abstain from conflicts of interest or unauthorised profits, unless there is express disclosure followed by informed consent. They disagree significantly, however, about why and to what extent, fiduciary duties should be enforced. Contractarians focus on the need to approximate the interests and expectations of both parties. Anti-contractarians tend to focus on one party to the relation. This is either the beneficiary of fiduciary duty, who is particularly vulnerable and in need of protection beyond that offered by the contractual tools, or the fiduciary, who undertook a position that is highly valuable for society and must therefore be held to standards that are higher than the average commercial morality. Consequently, anti-contractarians reject the gap-filling methodology for determining the content of fiduciary duties. In their view, the content should be determined based on values such as trust or morality, rather than outcome of a hypothetical bargain between the parties to the fiduciary relation.<sup>24</sup>

The decision in *MacRoberts* makes a clear case against the contractarian view. Lord Brodie brought clear and convincing arguments against regarding fiduciary duties as mere implied contractual terms. His explanations, however, do not go far enough to provide support for anti-contractarians. The judge rejected the contractual nature of the fiduciary obligations, but did not go on to analyse the underlying objectives that these obligations serve in the solicitor-client fiduciary relation. Given the continuing controversy surrounding the anti-contractarian arguments, the decision is a missed opportunity to advance our understanding of the reasons for the existence and strictness of the no-conflict fiduciary duty.

An emerging inter-disciplinary theory of fiduciary duties has the potential to bring new insights into the function of the strict proscriptive fiduciary duties and, potentially, to put the contractarian vs anti-contractarian debate to rest. Drawing on cognitive and behavioural research, the new theory argues that the strict no-conflict fiduciary duty plays an essential

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<sup>23</sup> See e.g. Victor Brudney, "Contract and Fiduciary Duty in Corporate Law" (1997) 38 Boston College Law Review 595 at 597; Deborah A. DeMott, "Beyond Metaphor: An Analysis of Fiduciary Obligation" (1988) 5 Duke Law Journal 879 at 891-892; Tamar Frankel, "Fiduciary Law" (2011) 71 California Law Review 795 at 799-802.

<sup>24</sup> Alces, *supra* note 21 at 353-354.

role in maintaining the reliability of fiduciary's exercise of judgment.<sup>25</sup> Recent interdisciplinary research shows that conflicts of interest have the potential to affect the reliability of a decision-maker's judgment in unpredictable ways, and despite the decision-maker's good faith and honest efforts to keep them aside.<sup>26</sup> Fiduciary conflict of interest situations are reprehensible because they create a *risk of error* in fiduciary's judgment, thus rendering his exercise of discretion less reliable.

The emerging theory points out that the strict no-conflict rules are needed to protect the fiduciary's exercise of judgment. Disloyalty, in this sense, means primarily unreliable judgment rather than selfish motivations. The court's statement in *MacRoberts* that the no-conflict duty requires an element of disloyalty, infidelity<sup>27</sup> or malice<sup>28</sup> are problematic. While in many cases a disloyal fiduciary seeks to pursue his own interests at the expense of the beneficiary, this may not always be the case. Actually, one of the hallmarks of the fiduciary no-conflict and no-profit rules is that they are unusually strict. Liability for breach of the proscriptive duties does not depend on the fiduciary's good faith or actual motives, on the fact that the beneficiary suffered no loss or obtained a benefit following the conflicted transaction, or on the fact that the opportunity that the fiduciary took for himself was no longer available to the beneficiary.<sup>29</sup> Consequently, something other than deterring infidel or malicious fiduciaries must be the principal purpose of the strict rules against conflict of interest and unauthorised benefits. The emerging inter-disciplinary theory of fiduciary duties makes a compelling case for regarding the proper and reliable exercise of fiduciary judgment as the principal concern of this area of law.

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<sup>25</sup> See Remus Valsan, "Fiduciary Duties, Conflict of Interest, and Proper Exercise of Judgment" (2016) 62:1 McGill Law Journal 1 (forthcoming); Lionel Smith, "Fiduciary Relationships: Ensuring the Loyal Exercise of Judgment on Behalf of Another" (2014) 130 Law Quarterly Review 608.

<sup>26</sup> Wayne Norman and Chris MacDonald, "Conflicts of Interest" in George Brenkert and Tom Beauchamp, eds., *The Oxford Handbook of Business Ethics* (Oxford: Oxford University Press, 2010) 441; Michael Davis, "Conflict of Interest" in Ruth Chadwick, ed., *Encyclopedia of Applied Ethics*, vol. 1 (London: Academic Press, 1998) 589; Don A. Moore and George Loewenstein, "Self-Interest, Automaticity, and the Psychology of Conflict of Interest" (2004) 17:2 Social Justice Research 189; Don A. Moore, Lloyd Tanlu and Max H. Bazerman "Conflict of Interest and the Intrusion of Bias" (2010) 5:1 Judgment and Decision Making 37.

<sup>27</sup> *MacRoberts LLP v McCrindle Group Ltd* [2016] CSIH 27 at [48].

<sup>28</sup> *Ibid.* at [53].

<sup>29</sup> *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461, at 471-472; *Bray v Ford* [1896] AC 44 at 51; *Parker v McKenna* (1874) LR 10 Ch App 96 at 124-125; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 at 144.



#### **D. CONCLUSION**

Lord Brodie's succinct analysis of the fiduciary no-conflict duty in *MacRoberts* is valuable for making a strong case against the contractarian approach to fiduciary duties. The persuasiveness of his views, however, is diminished somewhat by the absence of a clear explanation of the purpose of the strict no-conflict fiduciary duty.